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Standing Committee on Finance and Economic Affairs

ONTARIO TRADE REVIEW, 1988

VOLUME 2

Report on Meetings with the
Organization for Economic Co-operation and Development,
the European Economic Community and
the General Agreement on Tariffs and Trade

1st Session, 34th Parliament
37 Elizabeth II

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**1st Session 34th Parliament
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STANDING COMMITTEE ON
FINANCE AND ECONOMIC AFFAIRS

The Honourable Hugh Edighoffer, M.P.P.
Speaker of the Legislative Assembly

Sir,

Your Standing Committee on Finance and Economic Affairs has the honour to present its Ontario Trade Review, 1988, Volume 2, Report on Meetings with the Organization for Economic Co-operation and Development, the European Economic Community and the General Agreement on Tariffs and Trade and commends it to the House.

David R. Cooke, M.P.P. (Kitchener)
Chairman

Queen's Park
October, 1988



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PREFACE

The Standing Committee on Finance and Economic Affairs, in the course of its deliberations on the proposed Canada-U.S. Free Trade Agreement, was of the opinion that it was essential to view Ontario's trading relationships from a multilateral as well as a bilateral perspective. In September 1988, the Committee spent a week in extensive briefings on international trading issues from the Organisation for Economic Cooperation and Development (OECD) in Paris, the European Community in Brussels and the General Agreement on Tariffs and Trade (GATT) in Geneva. This report is Volume 2 of the Ontario Trade Review, 1988; Volume 1 is the Committee's report on The Canada-U.S. Free Trade Agreement.

In the course of its visit, the Committee was well looked after by the Delegation de l'Ontario, and the Delegation of Canada to the Organisation for Economic Cooperation and Development in Paris, by the Mission of Canada to the European Communities in Brussels, and by the Permanent Mission of Canada to the Secretariat of the General Agreement on Tariffs and Trade in Geneva. These organisations, together with the Department of External Affairs in Ottawa, efficiently organised the trip in Europe on behalf of the Committee and provided much valuable information. The Committee wishes to express its gratitude to the officials concerned, and to the representatives of the OECD, the European Community and the GATT who so willingly and generously gave of their time.

INTRODUCTION

In September 1988 members of the Standing Committee on Finance and Economic Affairs met with senior officials of the Organisation for Economic Cooperation and Development (OECD), the European Community (EC) and the General Agreement on Tariffs and Trade (GATT). The Committee's objectives were:

- to gain a greater understanding of the international trading environment, and the extent to which bilateral arrangements are congruent with multilateralism;
- to examine the European common market, and its implications for Canada and Ontario; and
- to understand the driving forces behind current issues in international trade.

These meetings provided the Committee with a wealth of information about the international trading environment. They reinforced the Committee's conviction of the importance of the GATT, provided a greater understanding of Europe's plans for 1992 and how they may affect Canada's and Ontario's relationship with Europe, and offered an appreciation of the role that the OECD plays in developing international economic and trade policies.

In order that the citizens of Ontario and the Ontario Legislature may also benefit from this material, this report summarizes the briefings received by the Committee. It is organised in three main sections. First, the background and current agenda of each organisation is described. Second, some specific issues that are in the forefront of Canada's and Ontario's concerns are discussed. Finally, there is a discussion of the broad themes that emerged from the briefings and their implications for Canada and Ontario, followed by concluding observations.

THE ORGANISATIONS

Organisation for Economic Cooperation and Development (OECD)

The OECD is not a supranational organisation but a place where policy makers can meet and discuss their problems, where governments can compare their points of view and their experience. The secretariat is there to find and point out the way to go, to act as a catalyst. Its role is not academic; nor does it have the authority to impose its ideas. Its power lies in its capacity for intellectual persuasion.

Jean-Claude Paye
OECD Secretary General
(1985)

Background

The OECD is an organisation that acts as a forum for economic and social policy debate that is outside the legal framework of an institution such as the GATT. The Secretariat, with a staff of 1,800, provides expert economic analyses which are used as a basis for discussion in committees and with the member country delegates. At the annual Ministerial meeting, policy issues from all the committees are drawn together and resolved at a political level. Within the OECD, many of the agreements reached may be informal and unpublicized, but may later be embodied in more formal actions. Generally actions are taken by consensus.

The work by the OECD may form the basis of national policies and of international agreements, such as the Government Procurement Code developed at the Tokyo Round of the GATT. In view of this indirect influence, some concern was expressed by members of the Committee about the independence of the OECD from its member countries.

The Committee was advised that while national statistics are provided by each country, the data are analyzed independently by an OECD committee and examined by two member countries. It is felt that the country studies were generally independent, tempered by diplomatic overtones. The report on the economic outlook of OECD members is produced every six months by independent experts in the Secretariat, with decisions made by consensus. The experts within the Secretariat are selected on the basis of merit, bearing in mind some geographical balance among members, but without regard to economic philosophy.

Current Agenda

The priorities of the OECD cover three main areas: improving economic policy coordination; supporting work in trade liberalization for the Uruguay Round of the GATT; and reaching out to engage key economies in Asia in the policy debate.

Ongoing work of the OECD involves the publication twice a year of the economic outlook of the OECD member countries, and in-depth studies of member countries. In a study of Canada released on September 19, 1988, the day the Committee met with the OECD, the OECD projects a real GDP growth of 4% in Canada in 1988 and, in the absence of a recession abroad, around 3.25% in 1989. This is one of the strongest projections published. The size of the Canadian federal deficit is the main criticism in the OECD study. It is felt that the deficit should be reduced in order to control the build-up of debt, to make investible funds available for productive investment and to contain inflationary pressures.

The OECD study comments that while The Canada-U.S. Free Trade Agreement is expected to lower consumer prices, expand market opportunities and lead to greater efficiency, it also carries the risk that demand may be diverted from lower-cost foreign suppliers outside the Agreement, thus hurting domestic consumers as well as foreign enterprises. A general multilateral lowering of trade barriers, for example through the GATT, would reduce this risk.

The OECD has studied agriculture since 1982, following an increase in government support of agriculture as a result of high input costs and low commodity prices in the early 1980s. To assist in achieving a reduction in agricultural subsidies and the fuller integration of agriculture into the multilateral system, the OECD has developed an aggregate measure of support to facilitate comparison between countries. This measure, known as a Producer Subsidy Equivalent (PSE) and generally expressed as a percentage of farm prices, represents the total transfers to producers from government and consumers (for example in higher prices paid for supply managed goods); it includes not only transfers by regulation and fiscal transfers but also from all programs that are unique to agriculture, including research and development. The OECD's work indicates that the OECD average PSE increased from 30% of farm prices in 1979-81 to 50% of farm prices in 1986. Canada's average PSE is close to the OECD average, and is higher in dairy products.

Members of the Committee expressed some reservations about the validity of the calculation of PSEs; the OECD acknowledged that the PSE is not a perfect measure but believes that it has great value as a tool to facilitate the process of negotiation in the GATT. These questions are discussed more fully in the section on agricultural issues.

As well as economic analyses, the OECD debates social and labour issues. From the postwar period until the late 1960s, unemployment in Europe was around 2.5%, lower than in North America. Since then, demographic changes such as an increase of female participation in the labour force, emerging structural imbalance and the oil shock have contributed to a relatively high unemployment rate (10% to 11%) with wide disparities both geographically and demographically. Demographic projections for 1990-2010 include continuing potential for female participation in the labour market. In the future, it is likely that there will be both high unemployment and labour shortages with the labour market split into two groups: traditional, skilled workers; and a pool of unskilled, hard-to-employ workers such as unemployed youth with no qualifications. The objectives of the OECD, in its Cooperative Action Programme on Local Initiatives for Employment Creation, are to find ways in which employment creation objectives can be integrated with business creation and regional development objectives, and to incorporate priority groups into the labour market. For example, their work includes ways to expand the entrepreneurial population and to encourage increased longevity of jobs, developing techniques to aid rural economies to diversify, and understanding the complex relationship between large and small firms in job creation.

One scheme which was initiated in France and is considered to be successful is the capitalization of unemployment insurance benefits, which was to be used for job creation purposes such as start-up capital for self-employment. Since 1981 approximately one million incorporations have resulted in Western Europe with an average of 1.7 jobs. Any displacement of resources has proved to be impossible to measure and is counterbalanced by the scheme's contribution to growth, especially for target groups that are otherwise hard to assist. It is not anticipated that such a scheme would lead to a challenge of subsidization under the GATT.

In financial services, the OECD has developed and is strengthening its Code of Liberalization of Capital Movements and the Code of Liberalization of Current Invisible Operations. In the Capital Movements Code, members undertake progressively to abolish restrictions on movements of capital; it is likely that the

Code soon will also cover short-term capital movements and add coverage of new instruments such as futures and options. There is ongoing discussion on the issue of using the principle of reciprocity rather than nondiscrimination. For example, countries with universal banking systems are pressing for reciprocity rather than national treatment when operating in those countries with separate banking and securities systems.

The Canada-U.S. Free Trade Agreement will be discussed in the Capital Movements Committee; some provisions, such as those giving preferential treatment to the U.S. in foreign ownership, will be debated and it is likely that some members of the OECD will express their regrets at these preferential provisions.

European Community

Background

The European Community incorporates the European Economic Community, the European Coal and Steel Community and the European Atomic Energy Community. Each community rests on a treaty relationship in which member states transfer selected areas of national sovereignty, such as trade policy, to the Community.

There are four main institutions of the European Community: the Commission, Council, Parliament and Court of Justice. The Commission (equivalent to the federal government without legislative power) is the executive of the Community and functions as a government with respect to the sovereign powers that have been given up by member states. There are 17 commissioners (equivalent to ministers) appointed by member countries but with allegiance to the Community, and 22 directors-general (equivalent to deputy ministers). The Commission has sole power of policy initiation and is also responsible for implementation once a policy has been approved by Council.

The European Council (equivalent to a council of ministers from Canada's 10 provinces) is the decision-making institution with legislative power. It is composed of one minister from each member state, either as a council of heads of state or in sectoral councils. The European Parliament is directly elected but has no legislative power. It has moral suasion power and can exert political pressure through its ability to dismiss the Commission as a whole and to approve or amend the budget.

The Court of Justice enforces European legislation and may annul national decisions and legislation which are incompatible with the provisions of the treaties; its judgements are binding on all courts in all member states. It comprises 13 judges and six advocates-general appointed for six years by common agreement of the member states.

The European Community has a population of 320 million, mostly fairly prosperous and with a GNP greater than that of the U.S. The Community conducts 20% of the world's trade (Canada has 3.4%), which is more than that of the U.S. and Japan combined. It is Canada's second largest export market (receiving 7% of Canada's exports in 1987, with 76% going to the U.S.) and, since 1986, its fastest growing export market. Two-way trade in 1987 was \$23.0 billion (\$8.3 billion in Ontario) with a Canadian deficit of \$4.0 billion (\$2.8 billion in Ontario).

Since 1976 Canada has had a Framework Agreement with the European Community to encourage an improved trading and investment relationship. It is overseen by the Joint Cooperation Committee, chaired at ministerial level, and by two subcommittees on science and technology and on industrial cooperation.

There has been little activity on industrial cooperation, partly because, unlike Canada, the European Commission does not deal directly with industry but with pan-European organisations and does not have in-depth knowledge of European industries. In addition, the framework may have aimed too high, for example, at large companies in the aerospace sector, that were competent to arrange their own international cooperation without government intervention. The relationship could be improved by choosing narrowly defined sectors with medium sized companies that need government assistance in cross licensing, joint ventures or joint development of products.

Science and technology cooperation has been more successful, with memoranda of understanding in sectors which include radioactive waste management, wastewater treatment, medical and public health research, thermonuclear fusion, raw materials and health and environmental effects of radiation.

Current Agenda

The most significant item on the agenda of the European Community is the completion of its internal market by 1992. The Treaty of Rome, which instituted the European Common Market, could have created this frontierless market but did not do so largely because of the protectionist attitudes of some member states. In the 1980s it became obvious that protectionism was resulting in a lack of competitiveness; industry became the driving force behind the move to transform the fragmented markets into a single market in order to gain the economies of scale required to maintain or increase European competitiveness with the U.S. and Japan. Completion of the internal market is expected to increase GNP by 4% to 6% over five years, and to create two - five million new jobs.

In 1985 the Council demonstrated strong political commitment by publishing a white paper on completing the internal market, although subsequent Councils have shown a reduced commitment. The Commission has produced a timetable of approximately 290 measures necessary to achieve the internal market. After four years, at the mid-term, there has been steady progress in the circulation of goods and trade in services, a principle has been established for standardization which promotes mutual recognition of differing standards providing they fall within certain minimum criteria, and there has been a reduction in national favoritism in public procurement.

A major outstanding problem is the harmonization of VAT (value added tax) which is necessary in order to be able to remove border controls. Additionally, standardizing VAT creates social difficulties for some member countries; for example, adding food to the items to be taxed in the U.K., or reducing the VAT rate in France, thus reducing its potential revenue for social programs. There are also problems with the free circulation of people, which is an issue at the core of national sovereignty.

France and Germany believe that a central banking system is necessary to achieve a frontierless market, but the U.K. is resistant to the idea and unwilling to lose sovereignty over its currency. A study group has been created, chaired by the President of the Commission, to work towards proposals for a central bank but it is not anticipated that these proposals will be forthcoming in the near future.

The Common Agricultural Policy (CAP) has been a cornerstone of the European Community and replaces national support measures. Its regime is based on guaranteeing a minimum price to producers, combined with import levies to protect farmers against the inflow of commodities at the world market price, and export restitution to enable European Community farmers to compete on the world market.

Two serious consequences of the CAP have been the build-up of permanent agricultural surpluses in Europe and its high budgetary and economic cost. Unlike the other common policies, agriculture expenditure has been unlimited, flowing automatically from the budget; it is reported to account for around two-thirds of the European Community's budget. Since 1985, therefore, the European Community has been in the process of reforming the CAP, for example, through an agreement to use the pricing mechanism for adjustment rather than institutional means such as quotas, through the use of stabilizer mechanisms to discourage overproduction, and by capping agricultural expenditure.

The promotion of research and development in pre-competitive areas is an important strategy for the European Community. Almost \$10 billion (approximately 2.5% of the European Community's budget) will be spent over the next five years on a research and technological development program with the primary objectives of enhancing European industrial competitiveness in strategic technology sectors and promoting the strengthening and cohesion of European economic development. The program complements and does not duplicate the research efforts of member states in their national programs, and enhances coordination between member states. It receives strong support from the European private sector because of the security for research work (over five years) which the annual budgeting cycles of member states cannot provide.

Canada is seeking to increase and perhaps formalize cooperation with Europe, particularly in the private sector. In July 1988 Canada formally asked the European Community to consider allowing it to participate in the European Community Framework Program on Research. The first response indicates that Canada may be able to participate in certain sectors that include thermonuclear fusion (a sector where there may be some potential contracts for Ontario), biotechnology, new and advanced materials, and information and telecommunications technologies. To be a full participant in the Framework Program, Canadian companies are required to have research facilities in Europe; however, the Program also allows for joint ventures with non-member countries for specific tasks.

General Agreement on Tariffs and Trade

GATT - The General Agreement on Tariffs and Trade - is a multilateral treaty, subscribed to by 96 governments which together account for nearly 90 per cent of world trade. Its basic aim is to liberalize world trade and place it on a secure basis, thereby contributing to economic growth and development and to the welfare of the world's peoples.

GATT Information Service

Background

The General Agreement on Tariffs and Trade (GATT) entered into force in 1948 and was based largely on selected parts of the charter for the proposed International Trade Organisation (ITO), a United Nations agency. The ITO was not ratified and the GATT became the only instrument laying down trade rules accepted by nations responsible for most of the world's trade. It is both a code of rules and a forum in which countries can discuss and overcome their trade problems and negotiate to enlarge world trading opportunities.

Member countries voluntarily accept the contractual rights and obligations which the GATT embodies, and overseeing the application of these rules is an important part of GATT activities.

The basic principle in the framework of trade rules is the "most-favoured-nation" (MFN) clause in which trade must be conducted on the basis of non-discrimination between all contracting parties; no country is to give special trading advantages to another or to discriminate against it, except under certain specified circumstances. The second basic principle is that where protection is given to a domestic industry, it should be extended through tariffs, which are visible, and not through other commercial measures. Other measures included in the framework of trade rules are the provision for consultation, conciliation and settlement of differences, waiver procedures where a country may seek derogation from particular GATT obligations and a general prohibition on quantitative restriction in imports.

The GATT, under Article XXIV, also permits regional trading arrangements, such as free trade areas, as an exception to the general rule of most-favoured-nation treatment, provided that certain strict criteria are met. These criteria include that duties or other regulations affecting the trade of members of the group with

non-members are required to be no more restrictive than those which were applied before the group was set up. Additionally, duties and other barriers to substantially all trade between countries in the group are required to be removed.

In its capacity of providing a forum for discussion and negotiations on trade, the GATT has organised several 'rounds' of multilateral negotiations; in 1947 (Geneva), 1949 (Annecy, France), 1951 (Torquay, England), 1956 (Geneva), 1960-61 (Geneva, the Dillon Round), 1964-67 (Geneva, the Kennedy Round) and 1973-79 (Geneva, the Tokyo Round). The present eighth round, the Uruguay Round, was launched in Punta del Este, Uruguay, in September 1986. The early rounds focused successfully on reducing tariffs. In the seventh round, the Tokyo Round, a series of new agreements were reached covering non-tariff measures, such as subsidies or government procurement, as well as further tariff reductions. The Uruguay Round is the most far-reaching and comprehensive round so far, including new issues of services, intellectual property and investment as well as further negotiations on agriculture and non-tariff barriers.

Finally, about two-thirds of the member countries of GATT are in the early stages of economic development. GATT recognizes its responsibility to assist their economic growth, and the General Agreement includes the principle that developed countries would not expect developing countries to make contributions inconsistent with their individual development, financial and trade needs. Developed countries also agreed that, where possible, they would refrain from increasing barriers to export of primary and other products of special interest to developing countries; they will accord differential and more favourable treatment to developing countries.

The most senior body of GATT is the Session of Contracting Parties, usually held annually, and attended by each member country. GATT decisions are generally arrived at by consensus. Between sessions, the Council of Representatives, which is open to all but generally consists of a more limited number of members, is authorized to act on both routine and urgent matters. The Consultative Group of 18 is composed of a representative group of high-level government officials with responsibilities in the formulation of their countries' trade policies, and is charged with following international trade developments and dealing with disturbances that could threaten the multilateral trading system. Standing committees and working parties (ad hoc committees) are set up to examine particular issues. The GATT Secretariat is relatively small with 300 people, 100 of whom are full time officers; there are 12 director level positions.

Current Agenda

The current agenda of the GATT incorporates the Uruguay Round of negotiations. There are 15 negotiating groups in the Uruguay Round which meet formally every five - six weeks, although much of the work is done informally between these meetings. The mid-term review, scheduled to take place in Montreal in December 1988, is serving to focus attention on the need to achieve some agreements before the end of the Round in 1990.

The Declaration agreed to by ministers when the Round was launched at Punta del Este is divided into two sections. The first covers trade in goods, with objectives that include seeking to bring about further liberalization and expansion of world trade and strengthening the role of the GATT. In addition ministers committed themselves to a standstill on new trade measures inconsistent with their GATT obligations and to a rollback of existing inconsistent measures.

The negotiations will address both tariff and non-tariff barriers; they include discussion on new issues such as trade related intellectual property and trade related investment measures, as well as in tropical products, natural resource-based products, textiles and clothing, agriculture, subsidies and safeguards.

The second part of the Declaration covers for the first time a negotiation on trade in services. It envisages the establishment of a multilateral framework of principles and rules for trade in services.

In addition, attention is being paid to strengthening the GATT, through improved functioning of the GATT system and by bringing increased discipline to the dispute settlement process.

Of the 100 countries that are members of the GATT or interested in participating, 30-40 play an active role in the negotiations. In particular, the developing countries are more involved and ambitious than in previous rounds, especially in the areas of textiles, agriculture and tropical products.

SELECTED ISSUES

During the week that the Committee spent in Europe, meetings with officials from the three organisations as well as from Canada's and Ontario's representatives provided the Committee with a wealth of information about international trading issues. While Canada and Ontario are affected to some extent by all these issues because of the increasingly interrelated nature of global relationships, this section will focus on those issues with the most direct relevance to Canada and Ontario.

Agriculture

Agriculture is a sector in which all countries recognize that there are problems and have shown a willingness for reform. The Common Agricultural Policy of the European Community has resulted in massive food surpluses and high budgetary and economic cost; the U.S. is reluctant to continue to draw on its Treasury. Also, the majority of disputes centre around agricultural issues, such as the use of subsidies, which may be a reflection of the lack of international trading discipline that results from agriculture's exemption from much of the GATT. The Uruguay Round is seen as an opportunity to resolve agricultural issues.

The objectives of the Uruguay Round include achieving greater liberalization of trade in agriculture, and bringing all measures affecting import access and export competition under strengthened and more operationally effective GATT rules and discipline.

The proposals tabled in the negotiating group reflect a wide disparity in position. The U.S. proposes phasing out all agricultural subsidies and import barriers over 10 years, by the year 2000. This would be achieved through the use of an aggregate measure of support, such as the Producer Subsidy Equivalent (PSE) developed by the OECD, and a timetable for the removal of support. The European Community, by contrast, focuses on the short term and proposes a freeze on support and stresses the need for a better balance between supply and demand. The Cairns Group, of which Canada is a member, is attempting to liberalize trade in agriculture by freezing support, and it proposes a reduction in the aggregate monetary level of output-based support by 10% in 1989 and 1990, with an exemption for developing countries.

Members of the Committee expressed concern with the use of PSEs as a basis for negotiation, and in particular with the inclusion of items such as research and development in their calculation. The PSE has been used as a negotiating tool in agriculture because the usual request-and-offer process had failed, with no offers forthcoming. Nevertheless, there was a suggestion that, if such an aggregate measure of support was to be calculated, it should be done for all industries, not only agriculture.

The Canadian government also has reservations about the PSEs. The Canadian position is to drop all except two of the categories used by the OECD, retaining market price support and direct payments. It is opposed to including items such as services (including research and development) and infrastructure as their effects are indirect and hard to quantify. In supply management, Canada also believes that there is a difference between open-ended support and those affected by import controls, and that the difference should be shown in the calculations.

Canada has tabled its own proposal as well as being included in the Cairns Group's proposal. This proposal includes the elimination of all subsidies that distort trade, some improvement in access in five years, binding tariff lines, and the use of the Trade Distorting Equivalent (TDE) which is a variation of the PSE but omits some elements deemed not to have an impact on trade.

Finally, a group of net importing countries, such as Egypt, Jamaica, Mexico and Peru, are concerned that removal of subsidies would result in higher food prices, and propose that compensation should be provided so that food bills do not rise.

There is mixed opinion on the likelihood of success in increasing discipline in international trade in agriculture. There are those who believe that it is a crucial issue, and that if the future of the GATT depends on resolving agricultural problems, most countries will be prepared to go to considerable effort to ensure that the negotiations are successful. Many countries are also becoming more aware of the budgetary and economic cost of ensuring producer incomes. On the other hand, there is a body of opinion that believes there is insufficient political will to make the necessary changes in domestic support when these are unpopular within the members' countries or contrary to domestic policy.

Dispute Settlement

One area of discussion in the Committee's hearings on The Canada-U.S. Free Trade Agreement has been on the question of the need for a dispute settlement mechanism that was separate from the GATT system. It had been suggested that the GATT system was slow and that decisions were not binding due to enforcement problems. The Committee therefore was interested to learn about the process of dispute settlement at the GATT and the measures being taken to strengthen it.

Under Articles XXII and XXIII a member country can ask for a GATT panel to study and resolve a conflict that has not been settled bilaterally. The tasks of a GATT panel are to conciliate and to examine disputes from a legal perspective; these tasks are sometimes in opposition to each other. There has been a rapid increase in the number of panels over the last two years, with up to 12 working at the same time. At the same time procedural problems have developed, such as the length of time taken to choose acceptable panelists or terms of reference, and the use of consensus to adopt a decision which allows the parties concerned to procrastinate. As a result, there have been complaints that the process is slow, taking up to two years, and that the panels do not express clear recommendations.

The issues being discussed therefore include ones which relate to speeding up the process by establishing a roster of 30 non-governmental panelists to be called on by the Secretary General if the parties cannot select panelists within 30 days, and by establishing standard terms of reference to be used if parties cannot agree on the terms of reference. Additionally, there is discussion over whether the right to have a panel is automatic or to be decided by Council, and on how to modify the consensus rule for adoption of a decision.

Key long term issues are how to implement panel findings and what obligation there is for implementation. An opinion was expressed that it is unrealistic to expect a sovereign state to accept the findings of GATT when it is politically impossible to do so domestically. Currently, there is no policing mechanism, and the only method of enforcement is for the injured country to request Council approval to take retaliatory measures. There is some question of the effectiveness of retaliation when there is an unequal distribution of power between the two countries, and there has been discussion on the use of fines rather than retaliatory measures.

There is optimism that some progress can be made in Montreal as there is some commonality of interest in tighter discipline. Concrete proposals can be expected on time limits, standard terms of reference, improved surveillance and a more formal role for arbitration. Agreement is less likely on whether member countries have the right to a panel in a dispute, and on how to adopt a decision.

Safeguards

Article XIX, the escape or safeguard clause of the General Agreement, permits emergency action to be taken against imports which are causing serious injury to domestic producers. Problems in this area have arisen from the interpretation and application of this Article, for example whether safeguard action can be applied selectively or on an MFN basis, and how to bring 'grey areas' such as voluntary export restraints (VERs) which are negotiated outside the GATT, back into international discipline. Typical examples of these grey areas are the Multi-Fibre Arrangement, to which Canada is a signatory and which covers trade in textiles, and VERs negotiated by industrialized countries including Canada to control the level of imports of automobiles from Japan. To date, there has been a useful exchange of views in the negotiating group, but the substantive issues have yet to be resolved.

Services

The Uruguay Round was initiated by the key issue of services which have not previously been included in the GATT. The initial objectives of the negotiating group are "to establish a multilateral framework of principles and rules for trade in services, including elaboration of possible disciplines for individual sectors . . . Such framework shall respect the policy objectives of national laws and regulations applying to services . . ."

While the rationale for trade in services is the same as for trade in goods, the problems are different as they affect not only transborder flows but also trade established in the other country. The U.S. has been the chief proponent for the formal inclusion of services into international discipline. The developing countries, led by India and Brazil, have expressed concern about the role of the service sector in their developing economies and the possible damaging impact of liberalization of trade in services. Labour mobility, especially of unskilled workers, is a crucial issue for some developing countries such as India or Korea. Canada has generally favoured the development of a framework of principles but has taken a cautious position on the issues of right of establishment and national treatment for foreign firms.

Frameworks for trade in services have been proposed by Canada, the U.S., the European Community, Scandinavian countries, Argentina and Mexico. Some of the elements to be negotiated are: the definition of what constitutes trade in services; the concepts on which the principles and rules for trade in services might be based, such as national treatment, transparency and non-discrimination; the coverage; and what constitutes a barrier. The OECD suggests that there could be a strong, framework of rules, principles and procedures, to be applied to all sectors immediately; however, in this case it is likely that some developing countries may not agree to participate, and the agreement may run into some of the same problems of selective application as encountered in trade in goods. Alternatively, there could be a weaker framework with the principles less clearly defined in order to include more countries; in this case, those who wish a stronger agreement could negotiate it sector by sector.

In the negotiating group, there has been little talk of coverage. However, there is some optimism that there may be some progress on principles now that countries such as Brazil, which previously blocked negotiations, are showing some flexibility.

Subsidies and Countervailing Measures

Canada and Ontario in the past have been affected by the lack of discipline in the rules on subsidies, especially in cases such as softwood lumber exports to the United States. The main objectives of the negotiations are to clarify the Tokyo Round Subsidies Code, including the definition of what constitutes a subsidy, and to tighten discipline in the use of subsidies. However, the negotiations have not progressed, owing to disagreement among members. On the one hand, the United States believes that the subsidy rules need to be tightened and that the application of countervailing duties should be as wide as possible. In contrast, the developing countries are opposed to loopholes in the existing rules on countervail that permit unilateral practices and interpretation by developed countries. At the Uruguay Round, Canada is playing a role in assisting the group in finding a framework for negotiation.

Trade Related Intellectual Property (TRIPs)

Negotiations on trade related intellectual property are a sensitive issue and a high priority with the U.S. and Europe who perceive that there is comparative advantage in high technology and creativity. The developing countries, however, are concerned with ensuring that the transfer of technology is not restricted. The GATT at present does not prevent nor require protection of intellectual property. The problems to be discussed include the norms or minimum standards for intellectual property rights, and discrimination and inadequacies in the enforcement of intellectual property rights.

On the question of norms and standards, there is almost a north-south split in position. The developed countries, led by the U.S., Japan and the European Community, want a comprehensive agreement including high standards. However, the developing countries do not believe that norms and standards are appropriate in the general Agreement and are not provided for at the Declaration at Punta del Este. A key issue to be settled in Montreal, therefore, is clarification of the mandate.

There is less disagreement on the principles of enforcement, and the means to prevent piracy and counterfeiting of intellectual property. Previous work on trade in counterfeit goods had reached a consensus on negotiating a multilateral agreement; any differences are mainly in extent, and vary among industrialized countries as well as north-south.

There is a balance still to be found in the negotiations between providing sufficient protection to encourage research and development on the one hand, against not restricting dissemination of information and technology on the other hand.

Trade Related Investment Measures (TRIMs)

Relatively little work was done on trade related investment measures (TRIMs) in the GATT prior to the Uruguay Round, and much of the discussion has been in developing a better understanding of the way in which investment measures function, what their trade effects are, and how they are related to GATT articles.

The U.S. is the chief proponent of the prohibition of TRIMs and has tabled 13 measures for consideration. The Committee observed that the position of the U.S. at the GATT was inconsistent with its position in The Canada-U.S. Free Trade Agreement and the U.S. Omnibus Trade and Competitiveness Act of 1988. It was suggested that the U.S. position in the Agreement was its bottom line, and that the present U.S. position may be a stepping stone for instituting new standards for investment in the next round of the GATT.

The European Community and the six countries in EFTA (European Free Trade Association) are concerned about some of the measures in the U.S. proposal, such as local equity requirements, and would like to focus only on those measures with a direct trade relationship. Japan's position is between that of the U.S. and the European Community; it is likely to take an active role in the negotiations as it is concerned by the discussions in the U.S. on control of foreign investment. Some of the developing countries do not believe that investment concerns the GATT, and are reluctant to include it. Others, such as the newly industrializing countries, are not prepared to consider prohibition of trade related investment measures but would use them as a subject for negotiation.

Canada has not put forward a proposal, but is endeavouring to find a way for the negotiating group to proceed. At present the group is going to Montreal without an agreement on the three issues.

IMPLICATIONS

The previous sections have largely been descriptive of the organisations visited and of some of the specific issues of concern to Ontario. Also of importance is the effect of these factors on the international trading environment, of which Canada and Ontario are a part, and of their implied opportunities and threats for Ontario. This section explores some of the broad themes that emerged from the Committee's discussions with senior officials in Europe.

Regional Trading Blocs and the GATT

Of particular interest to the Committee was the consistency of regional trading arrangements such as The Canada-U.S. Free Trade Agreement or the European Community's common market (a customs union) with the multilateral concepts embodied in the GATT. It is acknowledged that Article XXIV, which permits free trade areas and customs unions under certain criteria, runs contrary to the intent of non-discrimination. However, this Article recognizes the reality that such regional trading blocs existed when the GATT came into force, and may continue to exist; the GATT chose to incorporate such realities into the General Agreement, despite their inconsistency with its basic principles, in order to include as many countries as possible under its international rules.

The European Community has an extensive network of trading arrangements that conform in general to this Article, though few, if any, have been formally approved by the GATT. These arrangements include a free trade agreement with the EFTA countries (Sweden, Norway, Finland, Iceland, Switzerland and Austria); this agreement, rather than the European common market, represents a relationship similar to The Canada-U.S. Free Trade Agreement. The completion of the single market in Europe has caused some countries, especially those on the periphery such as Switzerland, to question whether they should apply to join the European Community. Any such enlargement of the European Community, together with the free trade arrangements that the U.S. is negotiating, adds fuel to international worries about the advancement of large trading blocs and the consequent erosion of the GATT.

The Canada-U.S. Free Trade Agreement will not be given a formal evaluation by the GATT until the Agreement has been ratified; at this time the Agreement will be studied by the appropriate GATT committee to evaluate whether it meets the criteria set out in Article XXIV. It is thought that there will be little problem with The Canada-U.S. Free Trade Agreement under Article XXIV since the intent of the arrangement is liberalization rather than protection. The general opinion at the OECD is that the integration of two markets is not bad for the world economy as long as it does not divert too much trade; the customs union of the European Community is seen to have led to an increase in world trade.

The informal reaction has been one of optimism and the belief that The Canada-U.S. Free Trade Agreement is positive to the extent that it does not obstruct improved multilateralism and the liberalization of trade. It has been emphasized, however, that the countries involved should take care to fulfill their international obligations. European reaction has been positive for the message that the Agreement sends to the multilateral discussions at the Uruguay Round on the willingness of the U.S., viewed as being increasingly protectionist, to negotiate on trade issues. The European Community does not see the Agreement as affecting the extent of trade and investment between Canada and the European Community.

Despite this guarded optimism, there are some underlying concerns with the Agreement. The Agreement is seen to send the message that unless trade issues can be solved multilaterally, there will be an increased risk of regional trading arrangements. Even if such arrangements individually are consistent with the GATT, there is increased risk arising from the multiplicity of differing rights and obligations that would result from many different arrangements. There are fears that, with the Agreement and the European single market in 1992, there are emerging regional trading blocs that may weaken the authority of the GATT. The countries that would suffer the most if such trading blocs took precedence over the GATT are the developing countries that would not be able to rely on international trade rules to assist their economic development.

There are already signs that some members of the GATT, such as the European Community and the U.S., may be unwilling to conform with the decisions of the GATT dispute settlement panel when to do so interferes with domestic policy. A decision not to implement a panel finding would be a signal of that country's lack of

commitment to international trading rules as represented by the GATT. Canada, and Ontario in particular, have encountered this same problem in choosing how to implement the domestically unpopular findings of the panel on Canadian wine marketing and distribution practices.

Some specific sections of The Canada-U.S. Free Trade Agreement may give rise to some concern. For example, the provisions giving preferential treatment to the U.S. in foreign ownership, or excluding offshore automobile producers from the Auto Pact, are seen as discriminating among members of the GATT. Provisions such as these may be the subject of dispute settlement in the future.

While it is generally believed that North America and Europe are committed to multilateral trade liberalization and are not building continental fortresses, how the trading arrangements will work out will depend on the success of the Uruguay Round negotiation and each country's success at managing their economies, avoiding recession and achieving an acceptable level of monetary stability.

Europe's Single Market in 1992

The European Commission views 1992 as the most significant event in Europe since the Second World War. The work of the European Community over the last two years to complete its single market by removing all physical, technical and fiscal barriers to trade by 1992 has drawn considerable media attention recently with much discussion of the creation of "Fortress Europe." Canada's sectoral advisory groups on international trade (SAGITs) have met with the European Commission and there have been visits by several of the provinces, though this is the first by a standing committee of a legislature. There has been the suggestion that Canadian business must quickly set up within Europe before 1992.

The European Community does not consider that its doors will be closed to trade from other nations in 1992. As a customs union, the Community has a common external barrier, and there are no directives to raise this external barrier as a part of completing the internal market. Despite these words, however, the Community has recently imposed penal duties on imports of VCRs from Japan, and there are fears that this may be the start of similar protectionist measures that may affect Canada and Ontario.

The Community also believes that there will be some advantages from the single market for foreign companies. For example, deregulation of trucking or the mutual recognition of standards will enable a foreign company to consolidate the number of products and distribution centres it needs in Europe. The projected 4% to 6% increase in European GNP over five years will also lead to an increased potential market for Canada and others. Ontario companies may be able to benefit from exporting to a large, single market rather than to a fragmented one.

Nevertheless, assuming that the internal market leads to increased competitiveness, there will be more challenge for Canadian business in Europe, and also in other markets around the world. Additionally, standards developed in Europe are likely to become the world standard outside North America and Japan, and Canadian companies will have to be aware of these standards and be prepared to meet them.

There is some diversity of opinion on the likelihood that Europe will be successful in completing its internal market. It is generally believed that there will continue to be progress in removing many barriers to trade in goods and services. However, problems expressed by certain member countries, such as the U.K., in giving up sovereignty in areas that relate to fiscal, monetary and immigration policies cast considerable doubt on the chance of complete economic and political union, certainly by 1992 and possibly ever. One reason for the lack of completion of the single market before 1985 was the protectionist attitudes of member states; it cannot be assumed that these have dissipated with the need for rationalization. Any vision of opportunities opening for Canadian companies as a result of completion of the single market should therefore be tempered by political realities.

One tactic in the European Community's strategy to become more competitive is to emphasize pre-competitive research and technology. The Commission has identified specific areas of research and has provided a budget for its framework program of research and technological development of approximately \$10 billion over five years. This framework program provides both threats and opportunities to Canada and Ontario. The threat exists from the potential competitive advantages that will derive from the larger scale of research and from the synergies from the coordination of research of the 12 countries.

The opportunity arises from the possibility for cooperation with non-member countries such as Canada in joint ventures with financing under the European framework program. While there have been some productive exchanges in the past at the fundamental research level between Canadian and European government laboratories, there has been little private sector interest. (However, those Canadian companies, such as Northern Telecom, with a subsidiary in a member country, can participate fully in the European research and development program.)

The Committee observed that this is a critical time for technological cooperation with the European Community; without further participation, Canadian access to European technology may be limited. Problems in generating interest in the private sector in Canada include a lack of knowledge of the major European programs and their strategic importance; the smaller size of many Canadian companies carrying out research and development makes matchmaking difficult. Canadian companies also tend to work at the applied, rather than pre-competitive, research level.

In June 1988 both Canadian and European ministers responsible for research and technology expressed interest in intensifying cooperation, perhaps in joint projects. In October 1988 an international project on nuclear fusion was announced involving the U.S., the Soviet Union, the European Community and Japan. Canada is participating as a part of the European delegation; there are opportunities in this project for Ontario's nuclear industry. Ontario industries, especially those prepared to work with firms from other provinces in order to form a larger group, may be able to take advantage of similar opportunities by actively seeking cooperative agreements, not only to enhance the level of research and technology but also to establish a presence in Europe.

Finally, unemployment has been a pervasive problem in Europe, with wide regional disparities as well as pools of permanently hard-to-place workers. The European Community recognizes that social cohesion is an integral and necessary part of economic rationalization. There are common rules on workplace health and safety. There is financial assistance towards restructuring for firms and regions, and retraining for displaced workers. The OECD is also actively seeking to find ways to integrate job creation and regional development objectives. Some of this work may be applicable to Ontario as it endeavours to assist the economic diversification of single industry towns, especially in the north, and in towns where the industries are declining.

Uruguay Round

The Uruguay Round is the first GATT round to be launched by consensus and is the most far-reaching, covering negotiations on a broader number of subjects than in previous rounds. It is important as it serves to give a focus to outstanding trading issues and to deal with concerns about U.S. protectionism, global trade imbalances and international monetary instability. Some are of the opinion that it is necessary for the Uruguay Round to succeed if the GATT is to continue to be influential in international trade discipline.

Of particular importance to the success of the Uruguay Round is a decision bringing increased discipline to agriculture, given the number of disputes in this sector. Despite the importance of achieving a decision, there remains a wide divergence of views between the U.S., Japan and the European Community, and no certainty that a decision will be reached. As discussed in the previous section, Canada, both individually and through the Cairns Group, is playing an important role at finding some middle ground.

Other areas where some decisions are necessary are tropical products, services and intellectual property. Some agreement on the issue of trade in tropical products is very important to developing countries; however, the U.S. has linked this issue to agriculture and it may therefore be hard to get a decision on tropical products without a decision on agriculture. For the U.S., rules covering services and intellectual property are high priorities, but there is much work to be done for any agreement on these subjects to be acceptable to developing countries.

The importance of the mid-term review at Montreal was frequently emphasized by officials. The proximity of this mid-term meeting in December 1988 is providing a catalyst for action in the negotiating groups as they focus on achieving some measure of progress to take to Montreal. There is a need for some hard decisions in Montreal, especially on agriculture, services and TRIPs, in order to keep the negotiations on track for completion in 1990.

Canada's main aims from the Uruguay Round are: to achieve more discipline, such as the binding of tariffs, in the trade policies of Korea, Brazil, etc.; to gain improved market access to Japan (e.g. for petrochemicals and resource-based products) and to the European Community (e.g. for lead and zinc); to increase discipline on export

subsidies; and to involve the developing countries. Canadian negotiators do not believe that The Canada-U.S. Free Trade Agreement is seen as tying Canada with the United States, to be treated as a single bloc, but rather has allowed Canadian negotiators to focus on market access with other countries, having previously negotiated a bilateral agreement with the U.S. Although the two countries have some complementary interests, they also differ in their approach in other areas such as services or TRIPs. Nevertheless, there is some perception among delegations that Canada and the U.S. may be treated as a single, North American entity.

The Uruguay Round provides a useful and necessary forum for multilateral discussions, especially for the smaller and less developed countries. Through the formation of alliances with others, small countries can have greater leverage in their negotiations with larger countries than if they were negotiating a bilateral agreement. Developing countries have taken a more active role in these negotiations than previously, and there is recognition that the rules and disciplines must respond to the needs of developing as well as developed countries.

The United States remains a major influence at the Uruguay Round, and the outcome of the presidential election is not viewed as affecting the Round. The European Community, which speaks for its 12 member countries, is also a strong and influential proponent of the GATT, and is attached to globality in the negotiations, hoping to achieve a balanced outcome with each participant having both gains and losses. The OECD also exerts indirect influence in the negotiations. By providing an informal forum for policy discussion prior to the negotiations, it may facilitate agreement among its members. Its analytical work, for example, the measurement of PSEs in agriculture, allows an exchange of views that may give some momentum to the process of debate in the Uruguay Round.

The GATT provides a means by which disputes can be settled, especially disputes between countries outside a regional trading block. With the threat of erosion of the trading system, and the increase in the number of disputes and questions on the effectiveness of their settlement, there are negotiations taking place in the Uruguay Round that aim to strengthen the functioning of the GATT system. This may be achieved through establishing a trade policy review mechanism in the GATT for international surveillance of domestic trade and economic policies, through formalizing greater ministerial involvement for increased political direction, and through tightening up the dispute settlement process.

The Committee observed that the GATT remains a vital instrument for the orderly expansion of international trade. The intensity of the debate in some of the negotiating groups and the pressure to reach some agreement in Montreal indicates a commitment by both the developed and developing countries to maintaining and enhancing the institutions and rules embodied in the GATT. The Committee supports this commitment.

CONCLUDING OBSERVATIONS

The movement towards completion of an internal European market by 1992 and the current GATT round of negotiations raise important international trade issues for Canada and Ontario. The Committee recognizes the significance and importance of the mid-term review of the multilateral trade negotiations in Montreal in December 1988. The Committee believes that Ontario, along with other provinces, should be fully consulted and included in this process and that its trade policy initiatives should be reviewed on an ongoing basis as the GATT negotiations proceed and events in Europe unfold.

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